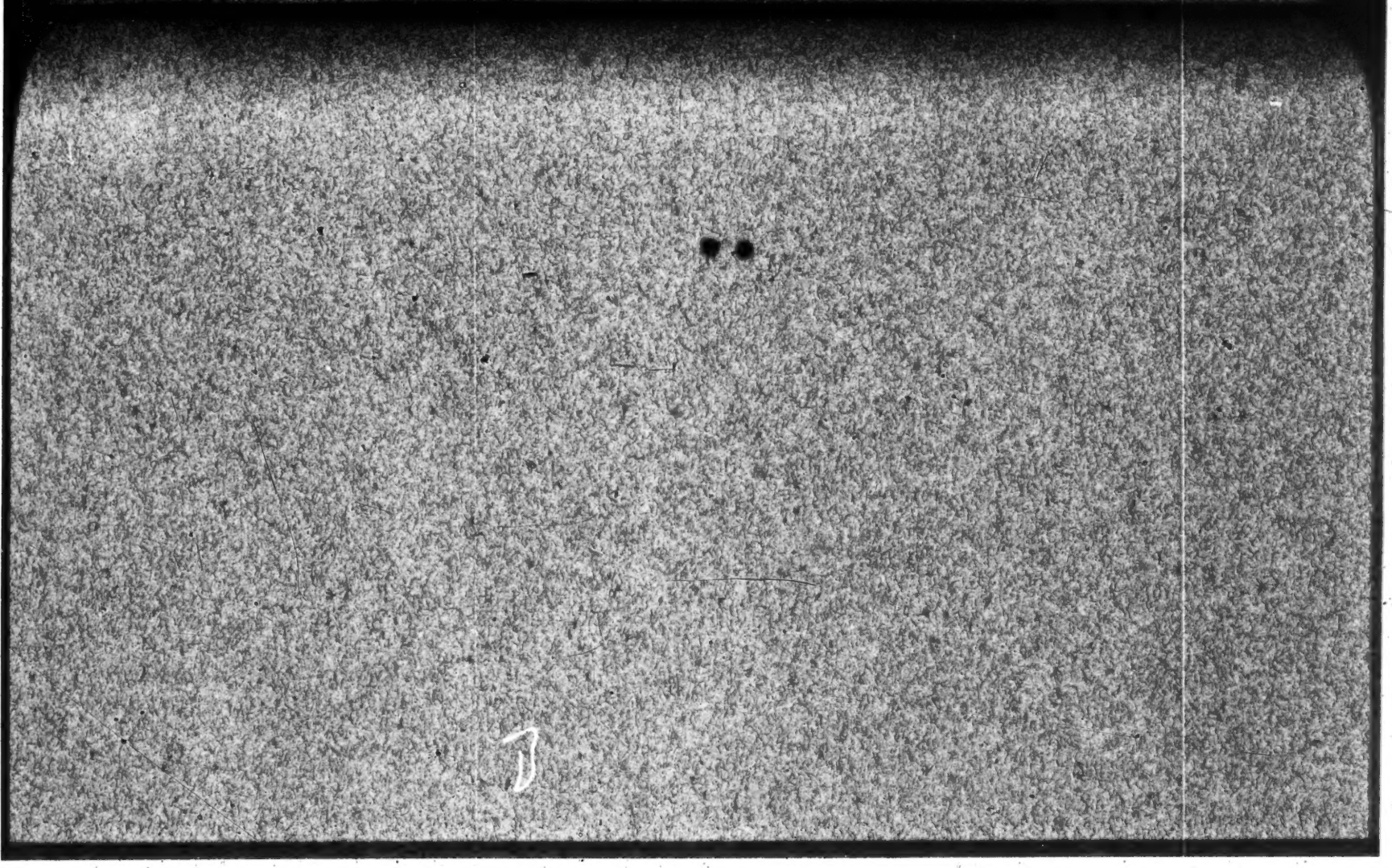

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No. 425

In the Supreme Court of the United States

OCTOBER TERM, 1930

GROUP NO. 1 OIL CORPORATION, PETITIONER

v.

JAMES W. BASS, COLLECTOR OF INTERNAL REVENUE FOR THE UNITED STATES FOR THE FIRST DISTRICT OF TEXAS

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE FIFTH CIRCUIT

BRIEF FOR THE RESPONDENT

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OPINIONS BELOW

The opinion of the District Court (R. 27–37) is reported in 38 F. (2d) 680. The opinion of the Circuit Court of Appeals (R. 47–49) is reported in 41 F. (2d) 483.

JURISDICTION

The judgment of the Circuit Court of Appeals was entered June 18, 1930. (R. 49–50.) A petition for rehearing was denied August 1, 1930. (R. 50.) Petition for a writ of certiorari was filed

September 6, 1930, and was denied October 20, 1930. Upon rehearing the order of denial was vacated and the petition granted on November 24, 1930. (R. 51–52.) The jurisdiction of this Court rests upon Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925.

QUESTIONS PRESENTED

1. Does a state statute providing that "Rights acquired under this Act shall be subject to taxation as is other property" include within its scope Federal taxation?

2. When the highest court of a State has construed a transaction to be a sale of property and not a lease, is the income of the purchaser resulting from the resale of the property subject to the Federal income tax?

3. Assuming that contracts between a State and a private party for the protection of oil and gas upon state lands are mere authorizations to take and use, and not sales of oil and gas in place, do the facts that the lands are owned by the State and that the royalty paid to it is used in support of state governmental activities prevent the Federal Government from imposing a tax upon the net income of the lessee derived from the sale of the oil and gas?

STATUTES INVOLVED

The United States statutes involved are set out in the appendix, *infra*, pages 25–26. The Texas statutes involved are printed at pages 87 *et seq.* of the brief for the petitioner.

STATEMENT

The petitioner, a Delaware corporation, seeks to recover income taxes for the fiscal years and fiscal period beginning July 1, 1924, and ending March 31, 1928, alleged to have been unlawfully collected by the respondent. (R. 1, 2, 22.) Claims for refunds were duly filed. (R. 3, 11–12, 22, 25.) The Commissioner of Internal Revenue rendered no decision thereon within the statutory period of six months, and accordingly this suit was brought. (R. 12, 25.)

A general demurrer and answer were interposed to the complaint. (R. 20–21.) Thereupon a jury was waived in writing (R. 21) and the case was tried on an agreed statement of facts (R. 21–25).

The taxes sought to be recovered were assessed upon income derived from the sale of oil and gas produced by petitioner under the terms of two instruments, one designated "Oil and Gas Lease No. 8560" and the other "Oil and Gas Lease No. 8607" (R. 4, 23–24, 13–16, 17–20), covering lands owned by the State of Texas, and were issued pursuant to the Texas Act of March 16, 1917 (R. 4, 6–7, 22–23, 25). By their provisions the leases were for periods of ten years with renewal privileges, and petitioner was required to pay as compensation for the rights conferred, in addition to a stated amount per acre, a sum of money equal to one-eighth of the value of the gross production of petroleum and a sum of money equal to ten per cent of the value of all gas sold. (R. 7, 14–15, 18, 25.)

The lands involved originally were parts of the public domain of the Republic of Texas, and by the terms of the resolution of Congress consenting to the admission of Texas into the Union title thereto was retained by the State "to be disposed of as said State may direct." A part of the lands so retained by the State was designated by the legislature for the support of the state university pursuant to mandates of the state constitution of 1876 directing the legislature to establish and provide for the support and maintenance of the university and appropriating 1,000,000 acres for that purpose. The lands leased are included therein. (R. 6, 25, 30.)

Upon these facts the District Court gave judgment for petitioner upon the theory that the income was exempt from Federal taxation. (R. 27–38.) Upon review the Circuit Court of Appeals reversed the lower court, holding that by express statutory provision petitioner's rights as lessee were subject to taxation. (R. 47–50.)

SUMMARY OF ARGUMENT

1. Assuming that petitioner's income would otherwise be exempt from Federal taxation, nevertheless it was subjected thereto by Section 27 of the Act of the Texas legislature of March 16, 1917, which provided that "Rights acquired under this Act shall be subject to taxation as is other property." The meaning of Section 27 is clear and unambiguous, and hence is not subject to construction.

It includes within its scope taxation by the Federal Government.

Even if Section 27 were subject to judicial interpretation it could not be construed to refer only to state taxation. Section 27 neither did nor could make anything taxable under Texas laws that was not so without it. Hence unless it applied to Federal taxation it was ineffectual to accomplish anything. A construction will not be adopted that will render a statute nugatory.

2. The Supreme Court of Texas has construed the contracts between petitioner and the State to constitute sales of oil and gas in place. This interpretation is binding upon the Federal courts as a rule of local property law defining property rights between two contracting parties, petitioner and the State. Accordingly, petitioner's income was derived from the sale of private property in which the State held no interest; and hence was taxable in the same manner as that of any other private party derived from the sale of private property.

3. Even if the transactions in question were leases, the income derived by the petitioner from its operations under these leases is not exempt from the Federal income tax. The effect of the tax is too indirect and too remote to constitute an interference with the functions of the State. The tax involved is, we submit, less direct and burdensome than the tax which this Court sustained in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514, or the tax sus-

tained in *Willcuts* v. *Bunn*, No. 22, October Term, 1930, decided January 5, 1931. The principle involved in these cases has been applied by this Court in numerous other situations.

The decision of this Court in *Gillespie* v. *Oklahoma*, 257 U. S. 501, is not controlling. The case does not decide primarily that income from an oil lease is exempt from taxation, but rather that the particular activity in which the United States was engaged was of such a high governmental nature that even a relatively remote tax upon it was an unconstitutional burden. Nor is the decision in *Long* v. *Rockwood*, 277 U. S. 142, in point. The decision in that case turned upon the peculiar characteristics of a sovereign grant of letters patent, and it can not form a basis for reasoning by analogy in the present case.

ARGUMENT

The constitutional question sought to be raised by petitioner is important only secondarily. The necessity for passing upon it arises only if two primary questions be decided adversely to respondent. These primary questions we discuss first under headings I and II.

I

ANY RIGHT OF EXEMPTION WHICH PETITIONER MIGHT OTHERWISE BE ENTITLED TO ENJOY WAS EXPRESSLY DENIED BY THE STATE OF TEXAS IN THE ACT UNDER WHICH PETITIONER'S LEASES WERE GIVEN

The Circuit Court of Appeals expressed no opinion upon the question of the constitutional right of

the United States to subject petitioner's income to taxation, deeming it unnecessary in view of Section 27 of the Texas Act of 1917, which provided that "Rights acquired under this Act shall be subject to taxation as is other property." It held that the State had thereby waived any exemption that petitioner might claim as an instrumentality of the State, and accordingly reversed the trial court.

Petitioner contends that Section 27 had reference only to state taxation, but concedes (Br. 67, 68) that its terms are sufficiently broad to include Federal taxation. It is clear, of course, that it was entirely within the power of the Texas legislature to subject petitioner's rights under the leases to taxation by the National Government. *Heiner* v. *Colonial Trust Co.*, 275 U. S. 232; *Shaw* v. *Gibson-Zahniser Oil Corp'n.*, 276 U. S. 575. And it is submitted that it acted in the exercise of this power, for otherwise it is only reasonable to suppose that Section 27 would have been limited by its terms to local taxation. And in this connection it is to be noted that the corresponding provision of the 1913 Act (Section 28, Act of April 9, 1913, Laws of Texas, 1913, c. 173), of which the Act of 1917 was an amendment, was equally without limitation.

But petitioner urges that Section 27 should not be held to mean what its language says on the ground that contemporaneous history indicates that the legislature had in mind only state taxation. It is thus sought by construction to limit the literal meaning of the statute. Resort to construction pre-

supposes a necessity therefor. It is not allowable where, as here, the language of the statute is unambiguous. *Ruggles* v. *Illinois*, 108 U. S. 526, 534. Rules of statutory construction "are only admissible to solve doubt * * *." *Wisconsin R. R. Comm.* v. *C., B. & Q. R. R. Co.*, 257 U. S. 563, 589. We admit no necessity for interpretation here. But we proceed to examine the contention.

The difficulty with petitioner's argument is that it makes Section 27 meaningless and ineffectual to accomplish anything. It is one of the first maxims of statutory construction that a statute should not be given an interpretation which will render it nugatory. It is asserted (Br. 63) that the immediate cause of the insertion of Section 28 in the 1913 Act, subsequently retained in the 1917 Act as Section 27, was the fact that litigation was then pending to determine whether or not an interest in an oil and gas lease was taxable property under the laws of Texas. It is pointed out (Br. 64) that the argument was being made that oil and gas before severance were not real property, and hence not within Section 7504 of the Texas Revised Statutes of 1911, which defines real property for purposes of taxation as follows (Br. 64.):

> Real property, for the purpose of taxation, shall be construed to include the land itself, whether laid out in town lots or otherwise, and all buildings, structures and improvements, or other fixtures of whatsoever kind thereon, and all the rights and privileges be-

longing or in anywise appertaining thereto, and all mines, minerals, quarries and fossils in and under the same.

It is at once apparent that neither Section 28 of the 1913 Act nor Section 27 of the 1917 Act could have any effect one way or the other in making oil and gas leases taxable under this statute. If the leases were within its terms, they were taxable as real property; if not, they were not so taxable. Sections 28 and 27, respectively, neither broadened nor restricted the definition contained in Section 7504. And the Supreme Court of Texas finally held (*Texas Co.* v. *Daugherty,* 107 Tex. 226) that interests under oil and gas leases were taxable solely because they came within the terms of Section 7504. If Sections 28 and 27 had reference to state taxation, as petitioner urges, they meant nothing whatever; they neither did nor could make anything taxable under state law which was not already taxable. If the intent of the legislature was to make sure that leasehold interests would be taxable by the State (as petitioner urges it was), the only method of doing so would have been by broadening the statutory definition if it was not then broad enough. This was proposed by House Bill No. 812 (Br. 65) introduced in the legislature March 8, 1913, but was rejected, apparently for the reason that Section 7504 as then existing was deemed broad enough, as was the case. It follows that Sections 28 and 27 were mere gestures unless they referred to Federal taxation.

The court below cited *Shaw* v. *Gibson-Zahniser Oil Corp'n.*, 276 U. S. 575, *supra*, in support of its position. Indian lands were there held to be subject to state taxation under Section 4 of the Act of May 27, 1908, c. 199, 35 Stat. 312, though the statute made no specific reference thereto. Section 4 reads as follows (Br. 69):

> All land from which restrictions have been or shall be removed shall be subject to taxation and all other civil burdens as though it were the property of other persons than allottees of the Five Civilized Tribes.

Petitioner criticizes the court's statement that the language of Section 4 is no broader than that of Section 27. We submit that the statement is correct. Section 4 is longer; but it is not more comprehensive than Section 27.

Petitioner urges (Br. 71) that the court below erred also on the ground that its conclusion would lead to the anomalous result that if three lessees should hold leases on three adjoining tracts of university lands—one under the 1917 Act, one under the 1925 Act, and the third under the 1929 Act—the 1917 lessee would be subject to Federal taxation, and the other two would not, since no provision similar to Section 27 appears in the two later acts. The contention affords no proper basis for according to the law something other than its literal meaning. See *Crooks* v. *Harrelson*, 282 U. S. 55, 59–60.

Yet another contention is advanced. (Br. 72 *et seq.*) It is argued that the 1925 Act repealed Sec-

tion 27 of the 1917 Act before any of the taxes now sued for were due. The repeal was by implication, it is urged, the 1925 Act covering the entire field of the 1917 Act. The answer is that the later law expressly provided in Section 1 that "oil and gas permits and leases outstanding shall not be affected by this Act except as provided in Section 14 hereof." Section 14 has no bearing here.

II

NO QUESTION OF TAXATION OF A STATE INSTRUMENTALITY IS INVOLVED AS PETITIONER'S INCOME WAS DERIVED FROM THE INDEPENDENT SALE OF ITS OWN PROPERTY, IN WHICH THE STATE OF TEXAS HELD NO INTEREST

The contracts between the petitioner and the State, though denominated "leases," have been consistently construed by the Supreme Court of Texas to be not mere authorizations of rights to take and use, but sales of oil and gas in place. *Texas Co.* v. *Daugherty,* 107 Tex. 226, *supra; Stephens County* v. *Oil & Gas Co.,* 113 Tex. 160; *Theisen* v. *Robison, Land Commissioner,* 117 Tex. 489. Indeed, under any other construction of the transactions, the Act under which they were authorized would have been unconstitutional under Section 12 of Article 7 of the Texas Constitution, which "requires the Legislature to dispose of the University lands by *sale* only." *Theisen* v. *Robison, Land Commissioner, supra,* at p. 502. We quote from the *Theisen case* (pp. 510–511):

The leases under either act accomplish no unconstitutional diversion of the University's permanent fund. They do not authorize the purchaser to take and use seven-eighths or any other mere fractional part of the oil or gas in the land leased. The purchaser instead buys *all* the oil and gas, for a stipulated price, part of the price being measured by the value of a certain fraction of the *produced* oil and gas, which is a very different thing from the value of that fraction of the oil and gas in place. The leases convey all the oil and gas in granting the right to find, produce, and appropriate *all* of them, in consideration of the payment of stipulated sums and also the value of a stated fraction of the oil and gas produced. The oil and gas when appropriated form no part of the University's permanent fund. While in place, before being sold, the oil and gas were potential assets of the fund. Like any other seller, the State, after parting with its title, no longer owns that which it has sold, but the State receives and turns over all the proceeds of sale when it receives and turns into the permanent University fund the royalties and other payments required by the acts. As a result of the sale, the purchaser owns the oil and gas, and the University permanent fund owns the entire proceeds of their sale.

As a matter of course, the State can sell no part or portion of its lands without diminishing the value of what remains. Should the

> State sell 80 acres out of an 160 acres of uniform value, that which remains would be worth only half the value of the entire tract. But, the State is none the poorer in retaining 80 acres and the proceeds of 80 acres. Exactly the same thing is true when the mineral estate in land is sold separately from the remaining estates, and it belies the experience of mankind throughout the ages to assume that there is any more profitable mode of sale for the realization of the full value of mineral bearing land.

This construction is binding upon the Federal courts in the situation here presented. We are aware of the rule that in applying a Federal taxing statute this Court is not bound by the construction of a local court but is free to make its own interpretation of the nature of any instrument under consideration. *Von Baumbach* v. *Sargent Land Co.* 242 U. S. 503, 518–519; *Burk-Waggoner Assn.* v. *Hopkins,* 269 U. S. 110, 114; *B. & W. Taxi. Co.* v. *B. & Y. Taxi. Co.,* 276 U. S. 518, 530. This principle is applicable in situations analogous to those in *Hirschi* v. *United States,* 67 C. Cls. 637, certiorari denied, 280 U. S. 576; and *Burkett* v. *Commissioner,* 31 F. (2d) 667 (C. C. A. 8th), certiorari denied, 280 U. S. 565, where the controversy turned upon whether or not the taxpayers' incomes were within the terms of the Federal taxing statute there in question. On the other hand, however, where the point in controversy relates to property rights as

between two contracting parties, the rule of the local court will be followed in the Federal courts. *Von Baumbach* v. *Sargent Land Co., supra; Waggoner Estate* v. *Wichita County,* 273 U. S. 113, 117. Accordingly, so far as the relationship between petitioner and its lessor is concerned, the interpretation of the Texas court is deemed to be controlling.

It follows that upon the execution of the contracts in question the State had no further control over or interest in the things sold, and that petitioner, from that moment, was the sole and complete owner of the oil and gas as fully as it might be the owner of any other object of property it might buy, whether from a State, a municipality, or some private individual. The source of petitioner's title is unimportant. In producing the income taxed by the United States petitioner was selling its own property, and occupied the same status as any private person would in disposing of his real estate or personalty. The price to petitioner or the manner in which it might have to pay or did pay is immaterial. All the transactions yielding the income upon which the tax in question was laid were parts of an enterprise as fully private in character as any enterprise can be. In *Weston* v. *City Council of Charleston,* 2 Pet. 449, 468, this Court said:

> When lands are sold, no connection remains between the purchaser and the government. The lands purchased become a part of the mass of property in the country, with no

implied exemption from common burdens. All lands are derived from the general or particular government, and all lands are subject to taxation.

Petitioner occupies the same status as did persons who purchased excess army and navy stores from the Federal Government after the late war for resale to the general public. No one would contend that a State might not constitutionally tax the incomes derived from such resales. The source of the dealers' title to the property sold would be without bearing. Equally so is the source of petitioner's title. Petitioner, in the same manner as such dealers, was engaged in an independent private enterprise. As such, its income is taxable.

Willcuts v. *Bunn*, No. 22, October term, 1930, decided January 5, 1931, is closely analogous. There the taxpayer sold municipal bonds to another private party. It was held that this was a transaction distinct from the contracts contained in the bonds themselves. The taxpayer had purchased obligations; they were his private property. And when he transferred them to another, he was dealing with what was his alone—he was making an independent sale of his private rights. So here the sale by petitioner of gas and oil was a transaction distinct from its purchase from the State; the resale was nothing more than a transfer of title to private property by its private owner.

III

EVEN IF THE TRANSACTIONS IN QUESTION WERE LEASES, THE INCOME DERIVED BY THE PETITIONER FROM ITS OPERATIONS UNDER THESE LEASES IS NOT EXEMPT FROM THE FEDERAL INCOME TAX

We contend that even though the petitioner's operations were carried on as a lessee of the State of Texas, the effect of a tax upon the net income of its business is too indirect and too remote to constitute an interference with the functions of the State. The tax is not laid upon the State; the tax is laid upon the petitioner, a private corporation organized for private profit. The tax is not laid upon the petitioner's gross receipts from the leases; it is laid upon the petitioner's net income derived from all its business, including any other business it may have apart from these leases. The tax is not discriminatory; it is laid upon the net income of all individuals throughout the United States. We believe that the decisions of this Court establish that such a tax is not an unconstitutional interference with the functions of a State.

In so far as taxes not directly laid upon a State or its instrumentalities are concerned, the limitation implied from the Constitution is not absolute and must receive a practical construction which permits both the National Government and the state governments to exercise their individual functions without serious impairment or interference. To extend the implied limitation too far is to defeat its very purpose by imposing unnecessary restrictions upon the sovereign power of taxation possessed

by both the state and national governments, and so distinctions must be carefully drawn, and their validity must be judged by the practical effect of the exercise of functions concededly possessed by one government upon the exercise of governmental functions concededly possessed by the other.

The tax involved in this case is, we submit, less direct and burdensome than the tax which this Court sustained in *Metcalf & Eddy* v. *Mitchell*, 269 U. S. 514. Metcalf and Eddy made contracts with States and subdivisions of States under which they performed engineering services with reference to municipal water and sewerage systems, for which they were paid from public funds. Like the petitioner in the present case, the engineers contended they were an instrumentality of the State, but this Court held them to be independent contractors and upheld the Federal income tax imposed on the moneys so received. In its opinion this Court said (pp. 522–523, 524–525):

> * * * it is apparent that not every person who uses his property or derives a profit, in his dealings with the government, may clothe himself from immunity of taxation on the theory that either he or his property is an instrumentality of government * * *.
>
> * * * * *
>
> The tax is imposed without discrimination upon income whether derived from services rendered to the State or services rendered to private individuals. In such a situation

> it can not be said that the tax is imposed upon an agency of Government in any technical sense, and the tax itself can not be deemed to be an interference with government, or an impairment of the efficiency of its agencies in any substantial way.

The same result was reached in two cases decided by this Court at its last term. *Lucas* v. *Howard*, 280 U. S. 526; *Lucas* v. *Reed*, 281 U. S. 699.

If Metcalf and Eddy had been employed to develop and manage the production and sale of oil on state lands, compensation received for such services would certainly have been taxable income. *A fortiori*, lessee's income here involved must be derived from operations under the lease and must be taxable under the Federal statute. Nor can the *Metcalf & Eddy* case be distinguished upon the theory that the lessees are governmental agencies engaged in the performance of governmental functions. It can hardly be said that the construction and maintenance of state or municipal water and sewerage works are less governmental than oil and gas developments or the maintenance of schools. Furthermore, in the *Metcalf & Eddy* case the income taxed was money received directly from the State, while in the instant case the income was derived from sales to third persons and the State's funds are not directly involved.

The principle involved in the *Metcalf & Eddy* case has been applied by this Court and other courts in numerous other situations. Thus, in *Veazie Bank* v. *Fenno*, 8 Wall. 533, this Court upheld a tax on notes issued by a bank operating under a state franchise.

In *National Bank* v. *United States,* 101 U. S. 1, a tax on notes issued by a municipality and used as money was upheld. In *Manhattan Co.* v. *Blake,* 148 U. S. 412, it was held that a Federal tax on the average deposits of a bank was not unconstitutional by reason of the fact that there were included moneys deposited by the treasurer of the State of New York. In *Snyder* v. *Bettman,* 190 U. S. 249, a succession tax on the transfer of property by will to a municipality was upheld. And in *James A. Sackley Co.* v. *United States,* 65 C. Cls. 304, it was held that the Federal income tax might be imposed upon receipts derived from a contract with the State to build a schoolhouse.

More recently, in *Willcuts* v. *Bunn,* No. 22, October Term, 1930, decided January 5, 1931, it was decided that the United States could impose a tax upon a profit derived from a sale by a private owner of municipal and state bonds. In that case this Court said:

> The sale of the bonds by their owners, after they have been issued by the State or municipality, is a transaction distinct from the contracts made by the government in the bonds themselves, and the profits on such sales are in a different category of income from that of the interest payable on the bonds.

Similarly, we submit that the sale of the oil and gas by the petitioner to third persons in the present case is a transaction distinct from the contracts made between the petitioner and the State, and that the

profits on the sales to third persons are in a different category of income from that paid by the petitioner to the State.

See also *Educational Films Corp.* v. *Ward*, No. 350, October Term, 1930, decided January 13, 1931, in which this Court held that a state tax imposed upon the privilege of doing business was not sufficiently burdensome on the Federal Government to be invalid even though the measure of the tax included the income from copyrights.

It should be borne in mind, in determining whether the present tax is a burden upon the State, that the tax is imposed upon net income and not upon gross receipts. This Court has frequently pointed out that a tax on net income does not constitute a direct burden upon the subject from which the income is derived. Thus, in *Peck & Co.* v. *Lowe*, 247 U. S. 165, and in *Barclay & Co*, v. *Edwards*, 267 U. S. 442, it was held that a net income tax may constitutionally be imposed upon the income derived from the business of exporting goods from the United States, although Clause 5 of Section 9 of Article I of the Constitution provides that "No Tax or Duty shall be laid on Articles exported from any State." And it has several times been held that a State may validly lay a net income tax upon income derived from interstate commerce. *United States Glue Co.* v. *Oak Creek*, 247 U. S. 321; *Shaffer* v. *Carter*, 252 U. S. 37; *Underwood Typewriter Co.* v. *Chamberlain*, 254 U. S. 113.

The petitioner relies principally upon *Gillespie* v. *Oklahoma*, 257 U. S. 501. Broadly speaking,

that case holds that income from an oil lease on restricted Osage Indian lands in Oklahoma can not be taxed by the State. The thought back of the decision is expressed in the decision in *United States* v. *Rickert,* 188 U. S. 432, 437, as follows:

> To tax these lands is to tax an instrumentality employed by the United States for the benefit and control of this dependent race, and to accomplish beneficent objects with reference to a race of which this court has said that "from their very weakness and helplessness, so largely due to the course of dealing of the Federal Government with them and the treaties in which it has been promised, there arises the duty of protection, and with it the power. This has always been recognized by the Executive and by Congress, and by this court, whenever the question has arisen."

The same thought is further expressed in *Shaw* v. *Gibson-Zahniser Oil Corporation,* 276 U. S. 575, in the following language:

> The end sought and the mode of attaining it adopted by Congress in the legislation providing for the welfare of the Indians by setting apart, by allotment and otherwise, tribal lands or the public domain, restricted for their benefit, led to the conclusion that those lands and the uses of them were so intimately connected with the performance of governmental functions as clearly to require independence of all state control so

> complete that nothing short of an express declaration by Congress would have subjected them to state taxation.

See also *Choctaw & Gulf R. R.* v. *Harrison,* 235 U. S. 292, 298; *Indian Oil Co.* v. *Oklahoma,* 240 U. S. 522, 530.

It requires no argument to show that the fulfillment by the United States of its treaty obligations with its dependent Indian wards is a fundamental governmental activity of the highest class, and that is the heart of the *Gillespie* decision. The case does not decide primarily that income from an oil lease of Government lands is exempt from taxation, but rather that the particular activity in which the United States was engaged was of such a high governmental nature that even a relatively remote tax upon it was an unconstitutional burden. Indeed, this definition was pointed out by this Court in its opinion in the *Gillespie* case itself. It was there said (p. 505):

> The criterion of interference by the States with interstate commerce is one of degree. It is well understood that a certain amount of reaction upon and interference with such commerce can not be avoided if the States are to exist and make laws. * *, * *The rule as to instrumentalities of the United States on the other hand is absolute in form and at least stricter in substance.* (Italics ours.)

And in *Jaybird Mining Co.* v. *Weir,* 271 U. S. 609, 613, this Court said:

> It is elementary that the federal government in all its activities is independent of state control. This rule is broadly applied.

In this respect there may well be a distinction between the activities of the United States and those of the States, because the exercise of power conferred upon the United States by the Constitution is necessarily supreme, while the exercise of non-governmental powers by the States is quite as clearly subordinate. *South Carolina* v. *United States*, 199 U. S. 437.

The decision in *Long* v. *Rockwood*, 277 U. S. 142, we submit, is not in point. In that case it was held that a State may not tax royalties derived from a patent granted by the United States. A patent is a sovereign grant and it was accordingly held by a divided court that the patent itself is an instrumentality created by law for the accomplishment of a governmental purpose. There was a sharp dissent in which four members of the court joined with considerable emphasis in declaring that it is not true that patents are instrumentalities of the Government. Thus, the decision turned upon the peculiar characteristics of a sovereign grant of letters patent, and is to be confined to the point decided. It can not form a basis for reasoning by analogy in so far as the case at bar is concerned, for a much closer analogy is found in a grant of land to be used for a governmental purpose. This Court in *Baltimore Shipbuilding & Dry Dock Co.* v. *Baltimore*, 195 U. S. 375, held that land conveyed by the

United States upon condition that the grantee should construct a dry dock thereon and accord to the United States the perpetual use of the dock was subject to direct taxation by the State. See also *Tucker* v. *Ferguson*, 22 Wall. 527; *Forbes* v. *Gracey*, 94 U. S. 762. Personal property used by a private corporation in the performance of a contract with the United States is clearly subject to local taxation. *Gromer* v. *Standard Dredging Co.*, 224 U. S. 362, 371.

CONCLUSION

For these reasons it is respectfully submitted that the decision of the Circuit Court of Appeals should be affirmed.

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APPENDIX

UNITED STATES STATUTES INVOLVED

The Revenue Act of 1924, c. 234, 43 Stat. 253, 267 (U. S. C., Title 26, Sec. 954), provides in part as follows:

> SEC. 213. For the purposes of this title, except as otherwise provided in section 233—
>
> (a) The term "gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including in the case of the President of the United States, the judges of the Supreme and inferior courts of the United States, and all other officers and employees, whether elected or appointed, of the United States, Alaska, Hawaii, or any political subdivision thereof, or the District of Columbia, the compensation received as such), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. The amount of all such items shall be included in the gross income for the taxable year in which received by the taxpayer, unless, under methods of accounting permitted under subdivision (b) of section 212, any such amounts are to be properly accounted for as of a different period.
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> * * * * *

Section 213 (a) of the Revenue Act of 1926, c. 27, 44 Stat. 9, 23 (U. S. C. App., Title 26, Sec. 954),

is the same as Section 213 (a) of the Revenue Act of 1924 set out above.

The Revenue Act of 1928, c. 852, 45 Stat. 791, 797 (U. S. C. Sup. III, Title 26, Sec. 2022 (a)), provides in part as follows:

> SEC. 22. GROSS INCOME.
>
> (a) *General definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.
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